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IN THE

Supreme Court of the United States

OCTOBER TERM, 1953

No. 178

CHARLES S. ROBERTS, upon his own behalf and on behalf of all other stockholders of OLD TOWN CORPORATION,
Petitioner,

v.

JOSEPH S. EATON, et al.,
Respondents,

AND

OLD TOWN CORPORATION, et al.,
Defendants.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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June 29, 1954

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

The above named petitioner, by the undersigned, his counsel, respectfully prays that a writ of certiorari issue to

review the decree of the United States Court of Appeals for the Second Circuit, entered April 5, 1954 (84),[1] affirming the order and judgment of the United States District Court for the Southern District of New York, granting summary judgment in favor of the respondents dismissing the complaint herein on the merits (P. App. 37, 38).

OPINIONS BELOW.

The opinion of the District Court is reported in 119 F. Supp. 362 (Adv. Sheets April 19, 1954), and is also printed in the record (P. App. 30-36). The opinion of the Court of Appeals is reported in 212 F. 2d 82 (Adv. Sheets June 7, 1954) and is printed in the record (77-83). Petition for rehearing (85-98) was denied without opinion, by order entered May 3, 1954 (99).

JURISDICTION.

The decree of the Court of Appeals was entered April 5, 1954 (84). Jurisdiction of this Court rests upon 28 U.S.C. §1254(1) (c. 646, 62 Stat. 928).

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[1] Record references are in parentheses. The Appendix to Brief for Plaintiff-Appellant below will be referred to herein as "P. App.," followed by the page number. The Appendix to Brief for Defendants-Appellees below will be referred to herein as "D. App.," followed by the page number. The proceedings had in the Court of Appeals, printed immediately following the Appendix to Brief for Defendants-Appellees below, and beginning with page 77, will be referred to merely by page number.

There are also references in the Court of Appeals opinion and herein to matter in the original record which, following the practice in the Second Circuit, was not printed in either of the appendices. We have filed in this Court the entire original record of the case, duly certified. Any references herein to the unprinted pages of the original record containing such matter will be made in the form "Rec.," followed by the page number.

STATUTES INVOLVED.

These are subsection (b) of Section 16 of the Securities Exchange Act of 1934, 15 U.S.C. 78p (b), and Section 3(a)(13) of the same Act, 15 U.S.C. 78c (a)(13).

The complete text of Sections 16(a) and (b) is set forth in Appendix A, pp. 22-23. The pertinent provisions of subsection (b) are as follows (emphasis supplied):

> "*For the purpose of preventing the unfair use of information* which may have been obtained by such beneficial owner,[2] director, or officer by reason of his relationship to the issuer, any profit realized by him from *any* purchase and sale, or *any* sale and purchase, of any equity security of such issuer * * * within any period of less than six months * * * shall inure to and be recoverable by the issuer * * *. *This subsection shall not be construed to cover * * * any transaction or transactions which the* [Securities and Exchange] *Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.*"

Section 3(a)(13), 15 U.S.C. 78c (a)(13), provides:

> "The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire."

PROCEEDINGS AND HOLDINGS BELOW.

The action was brought under Section 16(b) by petitioner, a stockholder of the nominal defendant Old Town Corporation, following the refusal of the company to bring it, to recover for the company profits realized by the respondents on a purchase and sale of the company's shares of common and preferred stock within a period of less than six months.

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[2] "Beneficial owner" is defined in Section 16(a) as a person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange.

The respondents moved for summary judgment under Rule 56 F.R.C.P. on the grounds that the acquisition in suit was not a purchase, and that certain of the respondents were not insiders, within the meaning of Section 16(b). The second contention was thereafter withdrawn and the motion was decided only on the first ground.

The respondents' motion was made simultaneously with service of their answer. Petitioner had no opportunity to examine them before trial, though notice therefor had been duly given. The issue was decided on affidavits alone.

The respondents' contention was that their acquisition of the new stock was not a purchase, because they had gotten it in exchange for their old by means of a reclassification of the company's securities under the Stock Corporation Law of New York.

Prior to reclassification the company's only stock was a $5 par common. The reclassification was one whereby the outstanding shares were exchanged for shares of new $1 par common plus newly created preferred stock.[1] The petitioner's affidavit showed that the reclassification was brought about by the respondents through exercise of their control of the company and its board (P. App. 5-9), in order to make an advantageous sale of the new securities. The Court of Appeals has found as to the motive that respondents were in negotiations to sell their stock "and discovered that its marketability would be improved by reclassification" (78). In fact, even after the stockholders, upon the respondents' recommendation, had voted approval of the reclassification, the respondents still retained the option whether and when to put it into effect, by voting themselves a resolution at the stockholders' meeting, which made the filing of the Certificate of Amendment "subject to a determination by the Board of

[1] The relevant provisions of the New York Statute are set out in the District Court's opinion (P. App. 33, fn.).

Directors that such action is in the best interests of the corporation" (P. App. 28, last "RESOLVED" paragraph; *In re McKinney*, 306 N. Y. 207, 117 N.E. 2d 256).

The District Court granted summary judgment, upon the ground that the acquisition of the securities by the respondents did not fall within the definition of purchase in *Shaw v. Dreyfus*, 2 Cir. 1949, 172 F. 2d 140, 142, *cert. den.* 337 U. S. 907, *viz.*, "to acquire something by one's own act or agreement for a price." The District Court refused to recognize any distinction between respondents, who by use of their insider position brought about and controlled the reclassification, and outside stockholders, but found broadly (P. App. 35-6): "The shareholders performed no act, made no agreement, paid no consideration for the reclassified stock."

The Court of Appeals rejected the respondents' contention and the District Court's holding. It affirmed, not on the ground that the acquisition was not a purchase within the established definition, but on the basis that the transaction was not comprehended within the purpose of Section 16(b), because in the Court's opinion this type of transaction does not lend itself to unfair use of information by insiders. The Court considered solely whether the characteristics of this kind of acquisition provide that "necessary prophylaxis" against unfair use of information which would warrant the Court in "immunizing" the transaction from application of the statute (82-83), and concluded (83):

> "The reclassification at bar could not possibly lend itself to the speculation encompassed by § 16 (b). This being so, it was not a 'purchase' and the decision below was correct."

A petition for rehearing, on the ground that this was tantamount to an exercise by the Court of the Commission's exemptive power, was denied.

QUESTIONS PRESENTED

1) Where a Federal statute for the correction of a public evil defines the area of its coverage as including "any" transaction of the kind proscribed but grants to the administrative agency concerned a discretionary power to exempt from that coverage transactions "as not comprehended within the purpose" of the statute, may the Federal courts independently find that a transaction is in all respects within the statutory definition and not exempted by the agency as not comprehended within the statutory purpose?

2) Even assuming that the courts may so find, was it correct to hold that here could not be unfair use of information in the purchase and sale of one in which controlling insiders, in order to make an advantageous sell-out of their holdings, used their control to bring about a reclassification of the company's securities under which they exchanged their stock for new and different stock of the seller, created for the specific purpose of consummating the intended sale, and, within a few weeks thereafter, consummated the sale?

3) Where a transaction involves the intricate and technical facts and usages of securities trading in public exchanges and the probable behavior of securities markets, is a court warranted in finding that the transaction is not comprehended within the statutory purpose without proof of the relevant factors and on the basis of theoretical reasoning that some factors affecting market prices probably and all others probably cannot, involve unfair use of information?

REASONS FOR GRANTING THE WRIT

The legislative history and the structure and language of the Securities Exchange Act of 1934 generally, as well as section 16(b) in particular, show that Congress was knowingly legislating in an area, and upon a subject matter, with respect to which it would have to leave to the administrative

The legislative history and prior decisions referred to herein are discussed in the brief accompanying this petition.

agency concerned a broad discretionary power to exempt from, and bring into, the application of the statute a variety of transactions and situations, in order to adapt the legislation to carrying out effectively the Congressional purposes. The legislation is of the type as to which the principle is established that where Congress has delegated such discretionary power to the administrative agency concerned, the courts will not themselves exercise the power.

The prior decisions under Section 16(b) have been consistent with the foregoing. The section has heretofore been construed to cover "*any* purchase and sale, or *any* sale and purchase," leaving it to the Commission, in *its* discretion, to determine what purchases and sales can be exempted without injury to accomplishment of the Congressional purpose, and upon what conditions this can be done.

The case at bar is the first one in which it has been held that a transaction which is in all respects a purchase, and which has not been exempted by the Commission, may nevertheless be "immunized" by the Court against application of Section 16(b) if, in the opinion of the Court, it is not comprehended within the purpose of the section.

This holding is contrary to uniform precedent. It radically reduces the coverage of Section 16(b) below what Congress enacted and intended. The Court below proceeded as if the intent and effect of the legislation are to provide only for the recapture of those profits that can be demonstrably traced to the use of inside information, and attempted to distinguish between factors affecting market value that the Court thinks can probably be so traced, and others that cannot. The statute, however, in order to accomplish its stated purpose of preventing the unfair use of information, draws no such distinction, but provides for the recapture of profits from any purchase and sale, or any sale and purchase.

The holding reads out of Section 16(b), for all practical purposes, the delegation of exemptive power to the Com-

mission for transactions "as not comprehended within the purpose" of Section 16(b). If the courts could hold, on that very ground, that what would otherwise be a purchase is not one, the Commission, in exercising its power, would be exempting only that which was never within the scope of the statute anyhow. Further, if the courts may substitute their judgment for that of the Commission where, as here, the latter has exercised its discretion against granting an exemption, then it would be equally open to the courts to review, in light of their independent judgment, an exemption granted or withdrawn by the Commission and its terms and conditions as specified by it.

Thus, for example, the Commission has, by recent amendment to Rule X-16B-6[5] (promulgated during the pendency of the case at bar), granted a guarded exemption to the disposition of securities by reclassification, depending upon the manner of their acquisition. Under the holding herein the courts could have created this exemption even in the absence of Commission action; they could extend it to *any* disposition of securities by reclassification, regardless of the manner of their acquisition; and they could modify the safeguards that the Commission thought necessary.

The impact of this holding is not limited to Section 16(b) of the Act. It would apply equally to the more than twenty further instances in which the Act grants discretionary authority to the Commission (or the Board of Governors of the Federal Reserve System, or the Secretary of the Treasury), to exempt or exclude transactions, securities or persons from the application of the legislation, or to bring them within its application, on the basis of "the public interest," "the protection of investors," the exclusion of matters "as not

[5] Set out in footnote at 81. The amendment is discussed and published in Securities Exchange Act of 1934 Release No. 5004, dated February 25, 1954.

comprehended within" the purpose of the legislation, and the inclusion of other matters "in order to carry out [its] purposes."

For example, Section 16(d) provides: "The provisions of this section shall not apply to foreign or domestic arbitrage transactions unless made in contravention of such rules and regulations as the Commission may adopt in order to carry out the purposes of this section." The instant decision would justify a holding under 16(d) that an arbitrage transaction, though not in contravention of any Commission rule or regulation, nonetheless is not an arbitrage transaction within the meaning of this section, because the Court thinks that the transaction could be made a means for unfair use of information and therefore deems it necessary so to hold "in order to carry out the purposes of this section."

Judicial discretion could thus be substituted for the prescribed administrative discretion throughout the Act, and, in fact, the precedent thus set would also be applicable to every other statute in which Congress has vested like discretionary powers in an administrative agency or public official.

This will involve the Federal courts in the making of quasi-legislative determinations not within their competency and for which they are not qualified, and in reviewing administrative exercises of discretion not intended to be thus reviewable. A reading of the Court's opinion herein shows that the Court recognized that it had entered into a field in which it is imperfectly informed; and its finding that the transaction in suit cannot lend itself to the prohibited mischief was arrived at upon speculative considerations of inconclusive force.

Such exercise of quasi-legislative discretion by judicial decision, where the agency having the discretion has thought it wiser not to act, would also destroy any assurance of uniformity in the administration of the statute, since the courts of the respective Circuits may find themselves in conflict;

and the action so taken must in any event, because of the nature of the judicial process, lack the flexibility and adaptability which characterize legislative action and are essential to its effective exercise. The Commission can narrow, or broaden, or rescind exemptions granted by it, as experience may suggest; but insofar as the exemption is established through the judicial process, such flexibility of corrective action is lacking.

Finally, if the courts may properly adopt the mode of statutory interpretation that was used in this cause, then they will have to pass upon the question whether or not the transaction involved lends itself to the unfair use of information in every suit under Section 16(b) and (d) in which that issue is in dispute. This turns upon facts and usages as to market practices, the probabilities of market reaction to any given type of transaction, the factors that go into the rise and fall of market values, and like matters in which the Commission is experienced and with which it is equipped to deal, but the courts are not.

In light of the foregoing, your petitioner respectfully submits that this application presents important questions of Federal law which have not been, but should be, settled by this Court, and a decision of Federal questions that is in conflict with prior authority and probably in conflict with applicable decisions of this Court.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari issue to review the decree entered in the United States Court of Appeals for the Second Circuit on April 5, 1954, affirming the order and judgment of the United States District Court for the Southern District of New York, granting summary judgment in favor of the respondents dismissing the complaint herein on the merits; that the said decree be

nted such other and

reversed; and that your petitioner be granted further relief as may seem proper.

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on,

Charles S. Roberts, upon his own behalf and on behalf of all other stockholders of Old Town Corporation,

By

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June 29, 1954.

BRIEF IN SUPPORT OF PETITION.

The Facts.

The following summary of uncontroverted facts is adequate to cover the points presented herein:

At the time of the transaction in suit, in 1952, Joseph S. Eaton (Eaton) and his family held the controlling block (45.9%) of the only outstanding stock of Old Town Corporation, a $5 par common. The Eatons controlled the company's Board of Directors.

Eaton decided to dispose of his own and his family's shares. He and his associates worked out a transaction for the sale of the Eaton block, plus enough additional shares to bring the total to more than 50% of the stock of the company. The sale was dependent, however, upon putting through a reclassification on terms to suit the purchasers, whereby (among other things) each share of the old common issued and outstanding would be changed into one share of new $1 common and one share of a newly created $7 par, non-voting preferred.

A ruling was obtained from the Treasury Department that the reclassification would be considered an exchange of old securities for the new, and would not result in taxable gain (Rec. 39). A Notice and Proxy Statement was then sent out to the stockholders recommending the reclassification and calling a meeting to be held December 30, 1952, at which they would vote upon it (D. App. 36a-54a). The Proxy Statement advised stockholders that, if they approved the reclassification, the management intended to file the Certificate of Amendment "on or about January 2, 1953" (D. App. 40a).

The Proxy Statement did not, however, disclose to the stockholders that the selling group intended to vote themselves, at the stockholders' meeting, the power of final decision over whether and when the reclassification should be consummated. They did this by putting through, in addition to the resolutions approving the reclassification, a further resolution that the Certificate of Amendment was to be filed

only *"subject to a determination by the Board that such action is in the best interests of the corporation"* (P. App. 28, last "RESOLVED" paragraph), despite the fact that the Board had already approved the reclassification and were recommending it to the stockholders (P. App. 26). This gave the respondents the option whether or not to reclassify the stock, and enabled them to control the timing as might best suit their interests. *In re McKinney*, 306 N. Y. 207, 117 N.E. 2d 256. The minutes of the December 30th stockholders' meeting show that none of the outside stockholders was present in person (P. App. 26).

As a matter of fact, the Certificate of Amendment was not filed until January 12th. The reasons for this delay, having to do apparently with working out final terms for the sale of the new securities, are discussed in the petitioner's opposing affidavit (P. App. 13). The respondents have never offered any other explanation for the delay.

Within a few weeks the selling group consummated, at a profit, the sales in furtherance of which the reclassification had been effectuated.

In this transaction the respondents obviously acquired, in exchange for their old securities, new securities comprising something substantially different in both legal and economic terms, carrying altogether new and different rights, privileges, priorities, and financial expectancies (D. App. 43a-48a). The respondents further recognized, and advised the stockholders, that the reclassification would "provide the stockholders with two types of investment, which in the opinion of the management should tend to improve the marketability and market value of their interests in the Corporation" (D. App. 39a).

In short, the respondents brought about this exchange of the securities owned by them for different securities of the issuer, in order to enable them to make an advantageous sale of the latter.

ARGUMENT.

POINT I.

The transaction in suit was a purchase, and the Court of Appeals, in "immunizing" it as not comprehended within the purpose of Section 16(b), exercised an exemptive power which Congress lodged exclusively in the Securities and Exchange Commission.

A. Prior Authority.

The respondents' exchange of the old securities for the new, brought about through exercise of their controlling insider position, constituted a purchase within the accepted import of the word and the prior decisions of the Court below; and the Court rejected the contrary holding of the District Judge. *Park & Tilford* v. *Schulte*, 2 Cir. 1947, 160 F. 2d 984, 987, *cert. den.* 332 U.S. 761; *Shaw* v. *Dreyfus*, 2 Cir. 1949, 172 F. 2d 140, 142, *cert. den.* 337 U.S. 907; *Blau* v. *Mission*, 2 Cir., 212 F. 2d 77 (Adv. Sheets, June 7, 1954), *cert. den.* June 7, 1954.

In the *Park & Tilford* case a conversion by insiders of their preferred stock into common stock of the issuer was held to be a purchase because they "did not own the common stock in question before they exercised their option to convert; they did afterward. Therefore they acquired the stock, within the meaning of the Act." The Court in this case sustained the position of the Commission, which argued in its successful brief *amicus* that "with one exception [an acquisition in good faith in connection with a previous debt] Section 16(b) was meant to include any mode of acquiring a security for consideration which is not exempted by the Commission under Section 16(b) 'as not comprehended within' its purpose." No valid distinction can be made in this respect, and the Court below suggested none, between a conversion brought about by controlling insiders pursuant to an existing charter right and one similarly brought about by charter amendment for the same purpose.

In *Shaw* v. *Dreyfus*, the Court held that purchase must be interpreted in its "popular or accepted import," and that "the generally understood meaning of 'purchase' is to acquire something by one's own act or agreement for a price." The Court further held that under this Act, purchase and sale also cover acquisitions and dispositions "similar to a purchase" and "similar to a sale," respectively.

In *Blau* v. *Mission*, the Court held a transaction to be a sale even though it was "mathematically demonstrable" that the transaction did not change the seller's proportionate interest in the issuer, except in form, and reasoned that to hold otherwise "we must read a very serious limitation on the normal meaning of sales as between intercorporate entities."

The above cases are consistent with *Smolowe* v. *Delendo*, 2 Cir. 1943, 136 F. 2d 231, 236, *cert. den.* 320 U.S. 751. It was there held "that the preamble [to Section 16(b)] was inserted for other purposes than as a restriction on the scope of the Act." The preamble, said the Court, was inserted "as an aid to constitutionality" and for "the desirable purpose of a guide to the Commission in the latter's exercise of its rule-making authority." The holding herein, that there was no purchase because in the Court's opinion the transaction could not possibly lend itself to unfair use of information, turns the preamble into precisely what the *Smolowe* case says it is not, "a restriction on the scope of the Act."

This holding is contrary to the intent of Congress and the statutory scheme.

B. Congressional Intent.

There are set out in Appendix B (pp. 24-26) the relevant statements of the House and Senate Committees in their respective Reports regarding this legislation. While the House bill did not contain the equivalent of Section 16(b), the Senate bill did. It is plain from these Reports that the Committees of both Houses agreed that the legislation was of a character

which made it indispensable to vest the administrative agencies concerned with wide, discretionary quasi-legislative powers in order to carry out the Congressional purpose, and that this consideration underlay the provisions of Section 16(b) as well as the other portions of the statute in which such powers are granted to the Commission, the Board of Governors of the Federal Reserve System, and the Secretary of the Treasury respectively.

C. The Statutory Scheme.

This was correctly understood and interpreted in the decisions prior to the holding herein.

Section 16(b) covers, unqualifiedly, "any purchase and sale, or any sale and purchase." Congress recognized, however, that this "root and branch" legislation could result in liability for transactions that might be free of the evil intended to be corrected. Accordingly, the exemptive power in Section 16(b) was provided, because it "offers an opportunity for the Commission to utilize its administrative experience in relieving from the section's arbitrary rule of thumb those transactions not susceptible to the abuses against which the section is directed." *Cook & Feldman, Insider Trading,* 66 Har. L. Rev. 33.

This conforms to the pattern of the Act throughout. Where Congress thought it could safely do so, it wrote into the statute specific exemptions.[6] On the other hand, where Congress deemed it unwise to create a rigid statutory liability, or unsafe to grant an absolute exemption, it provided in the first situation for power of exemption to the Commission such as the one here in question, and in the other situation for power in the Commission to bring transactions

[6] Two such exemptions occur in Section 16(b): where the "security was acquired in good faith in connection with a debt previously contracted," and the situation in which "such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved."

within the operation of the statute, such as appears in Section 16(d).

The statutory scheme is thus identical, and the purpose the same, both as regards the power to exempt and the power to include. The intent was to avoid "statutory enactments that could not be changed in case of need without Congressional action" (House Report, Appendix B), and "to avoid, on the one hand, unworkable 'straitjacket' regulation and, on the other, loopholes which may be penetrated by slight variations in the method of doing business" (Senate Report, Appendix B).

POINT II.

The Court of Appeals has performed in this case a legislative or administrative, and not a judicial, function.

The power of the Commission to exempt transactions "as not comprehended within the purpose" of Section 16(b), or to include them if they contravene rules and regulations adopted by the Commission "in order to carry out the purposes of this section," is a power to act under a Congressional charter to determine what means will be effective, and what ineffective, to accomplish the statutory purpose. This is a legislative and not a judicial power. The holding below goes against the unbroken current of authority that teaches that this separation of powers must be observed by the courts.

In *Scaife Company* v. *Commissioner of Internal Revenue*, 314 U.S. 459, the statute authorized the Commissioner to adopt rules and regulations extending the time for filing a tax return by not more than sixty days. A Treasury Regulation provided for such extension upon compliance with specified conditions. The taxpayer, discovering a clerical mistake in its first return, filed an amended return within the sixty-day period, but without compliance with the Treasury conditions. This Court held that the courts did not have power

to relieve against the mistake, and said (p. 462): "If we were to grant petitioner the extension which it asks, we would be performing a legislative or administrative, not a judicial, function."

The principle of decision in the above case was twofold: *first*, that the power to promulgate rules and regulations of a certain type is not the equivalent of a regulation of that type duly promulgated; *second*, that where the statute gives power to the administrative agency to grant relief from the application of the statute consistent with the Congressional purpose, there has been vested in the agency a legislative function which the courts will not assume to exercise.

Under this principle it was improper in the case at bar for the Court to exercise the Commission's power to exempt the transaction in suit as not comprehended within the purpose of Section 16(b). The fact that this was done through judicial interpretation of "purchase" for purposes of Section 16(b) does not change the substance of what has actually occurred.

In *Addison* v. *Holly Hill Fruit Products*, 322 U.S. 607, the Act exempted from its scope employees "within the area of production (as defined by the Administrator), engaged in * * * canning of agricultural * * * commodities for market." The Administrator promulgated a regulation defining the "area of production" in a manner not authorized by the statute. The regulation was held *ultra vires*. The Court further held, however, that while the statutory mandate for exemption must be given effect, this was for the Administrator to do, and it so directed in the remand. The ground of holding was (p. 614) that in the statute "Congress left the boundary-making to the experienced and informed judgment of the Administrator," and gave him "appropriate discretion to assess all the factors relevant to the subject matter," hence "judgment belongs to him and not to the courts."

These cases accord with the decisions of this Court, that where Congress has delegated to an administrative agency a quasi-legislative power requiring the special knowledge, experience, and services of the administrative tribunal to determine technical and intricate matters of fact, and a uniformity of ruling is essential to comply with the purposes of the regulatory statute, the courts will not exercise that power.[7]

The cases in this line are not on all fours with the one at bar, because they arise in a different statutory context, but the principle on which they were decided is applicable to the respective functions of the courts and the Commission with regard to the exemptive power here under discussion. This principle has special force where, as here, the Court has itself recognized that it is acting in a field in which it is inadequately informed, and, expressing regret that it lacked guidance from the Commission, has said that "haltingly we have endeavored to effectuate the statutory mandate to curb insider short-swing speculation" (80), and further, that "left

[7] See, for a compilation of cases, the annotation on "doctrine of primary administrative jurisdiction" in 94 L. ed. 806, *ff. Slocum* v. *Del., L. & W. R. Co.*, 94 L. ed. 795 (339 U.S. 239). The cases in this line lay down the following principles: The courts will respect the Congressional intent to grant the exemptive power to the designated agency (*Gray* v. *Powell*, 314 U. S. 402). They will be slow, even under the power of review, to interfere with the agency's exercise of the discretion entrusted to it (*Gray* v. *Powell*, *supra*; *SEC* v. *Chenery Corp.*, 332 U. S. 194, 207-8). They will respect the reason for the delegation, which is variously stated: that the operative facts are "generally unfamiliar to a judicial tribunal, but well understood by an administrative body especially trained and experienced in the field," and that such administrative body is "better equipped than courts by specialization, by insight gained through experience, and by more flexible procedure" to ascertain and arrive at an appropriate determination (*Far East Conference* v. *U. S.*, 342 U. S. 570, 573-5; *U. S. Navigation Co.* v. *Cunard*, 284 U. S. 474); that the designated agency can exercise "an informed, expert judgment on the problem," and that the determination of the agency "is the product of administrative experience, appreciation of the complexities of the problem, realization of the statutory policies, and responsible treatment of the uncontested facts" (*SEC* v. *Chenery Corp.*, *supra*, pp. 207, 209).

to our own resources we are not inclined at this juncture to attempt enunciation of a black-letter rubric" (82).

The first of the above statements, it is respectfully submitted, reflects an erroneous conception of the function of the courts under Section 16(b), which is, to effectuate the statutory curb by enforcing the liability for profits as prescribed. The statutory mandate is that the Commission, not the courts, may relax such curb. As to the second of the above statements, we submit that the Court has really done exactly what it disclaimed any intention to do.

POINT III.

The Court erred in finding that unfair use of information could not occur in the transaction at bar, and, in any event, in so finding without proof of the relevant factors.

The Court of Appeals has found that the reclassification was proposed by the respondents because they were in "negotiations to sell their remaining stock and discovered that its marketability would be improved by reclassification" (78a-79a).

The opinion below, while conceding "that a veteran of the market place can venture a shrewd guess" as to what would happen marketwise to the newly acquired securities (82), concludes on the basis of *a priori* reasoning that the profits from the sale that followed are not attributable to the use of inside information. The conclusion does not follow from the premise.

Let us assume the case of the insider who has private knowledge of adverse developments in his company's affairs and desires to sell out or reduce his holdings before the facts become generally known. He would do exactly what the respondents did in this case, and precisely because he thinks

that the marketability of his stock "would be improved by reclassification." Plainly, in such a case, the reclassification would be a means whereby such insider was able to make unfair use of information.

The case at bar is not distinguishable in this or any other material respect from *Park & Tilford* v. *Schulte, supra.* In both cases insiders, wishing to sell their shares to better advantage, exchanged one type of security for another in order to facilitate the sale and/or get a better price. It would have availed the defendants in the *Park & Tilford* case nothing whatever, to show that they made their exchange because of their views as to market behavior generally, and without any benefit or thought of inside information. In fact, proof to that effect would not even be received, since it would show only that the defendants *did not* make unfair use of information, and not that they *could not* have done so. Section 16(b) does not deal with subjective motivations but with conduct, because that is the only way to reach effectively breaches of fiduciary obligation (*Gratz* v. *Claughton*, 2 Cir., 187 F. 2d 46, 49; *Smolowe* v. *Delendo, supra*, 136 F. 2d at p. 239).

In any event, the question whether any given transaction of purchase and sale lends itself to the unfair use of information is not one to be decided upon abstractions, but upon ascertainment of the relevant factors and their actual workings. In its holding herein the Court has found three distinctions between the case at bar and the prior cases (80), and has said as to them (82): "Strong arguments have been advanced against each of the enumerated distinctions as not certainly insuring the necessary prophylaxis to the transaction; but each is to some degree persuasive that the transaction is not susceptible to abuses within the ambit of § 16(b)." After consideration of these factors the Court concluded (83): "As a matter of fact it seems quite possible that no one of the factors we have enumerated, standing

alone, would be sufficient for that result. But in cumulative effect we think they are."

This arithmetical procedure is not applicable to the question involved; the items do not add up to the announced total; and it is plain that the Court was itself in uncertainty as to both the items and the total. The opinion shows on its face the basic error as well as the impracticality of having the courts, by their own resources, exercise on theoretical reasoning the exemptive power which Congress left to the Commission, to be exercised in light of fact and actual experience.

Accordingly, even assuming *arguendo* that the courts may properly determine that a transaction that would otherwise be a purchase and sale may be immunized by them "as not comprehended within the purpose" of Section 16(b), it would be error to do so as has been done here, by summary judgment arrived at without the necessary proof.

Respectfully submitted,

HENRY H. SHEPARD,
MURRAY C. BERNAYS,
Counsel for Charles S. Roberts, upon his own behalf and on behalf of all other stockholders of Old Town Corporation,
Petitioner.

June 29, 1954.

APPENDIX A.

Securities Exchange Act of 1934, Sections 16 (a) (b), (15 U. S. C. §78 p (a) (b)).

"§ 78 p. *Directors, officers, and principal stockholders.*

(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security or within ten days after he becomes such beneficial owner, director, or officer, a statement with the exchange (and a duplicate original thereof with the Commission) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been any change in such ownership during such month, shall file with the exchange a statement (and a duplicate original thereof with the Commission) indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court

of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

APPENDIX B.*

Extract From Report of House Committee on Interstate and Foreign Commerce, to Accompany H.R. 9323 (Report No. 1383, 73d Congress, 2d Session, p. 6).

"The constitutional significance of the wide delegation of powers to the Federal Reserve Board and to the Federal Trade Commission, which would administer the act, has been considered with particular care—and the delegation made only with the indication of such maximum standards for discretion as, in the considered judgment of the Committee, the technical character of the problems to be dealt with would permit. The bill legislates specifically just as far as the Committee feels it can. The original bill submitted to the Committee dealt very specifically and definitely with a number of admitted

* The Securities Exchange Act of 1934 eventuated from H.R. 9323, as amended by the Senate (S. 3420) after passage by the House, and as reconciled in conference by the Committee of Conference of the two Houses.

abuses. In many cases, however, the argu the argument was made that while the solutions offered might l might be correct, their effects were so far-reaching as to make p make it inadvisable to put these solutions in the form of statu of statutory enactments that could not be changed in case o case of need without Congressional action. Representatives tatives of the stock exchanges constantly urged a greater degr ter degree of flexibility in the statute and insisted that the com the complicated nature of the problems justified leaving much g much greater latitude of discretion with the administrative istrative agencies than would otherwise be the case. It is for t is for that reason that the bill in dealing with a number of di ber of difficult problems singles out these problems as matters a atters appropriate to be subject to restrictive rules and regulati regulations, but leaves to the administrative agencies the deter he determination of the most appropriate form of rule or regul or regulation to be enforced. In a field where practices const ces constantly vary and where practices legitimate for some pu some purposes may be turned to illegitimate and fraudulent m dulent means, broad discretionary powers in the administrativ inistrative agency have been found practically essential, despite t despite the desire of the Committee to limit the discretion of the on of the administrative agencies so far as compatible with worka ith workable legislation. It has been represented that the pleas of pleas of the representatives of the stock exchanges for the ve r the vesting of broad discretionary powers in the administrativ inistrative agencies have been made with a view to subjecting t jecting the bill to constitutional attack at a later date. The C te. The Committee has, however, taken the pleas in good faith bel faith believing that the nature of the legislation is such as to just as to justify within constitutional limitations that measure of easure of flexibility required in dealing with so intricate a su icate a subject matter."

Extract From Report of Senate Committee on Banking and Currency, to Accompany S. 3420 (Report No. 792, 73d Congress, 2d Session, pp. 5-6).

"II. GENERAL ANALYSIS OF THE BILL.

1. Enforcing Agency and Flexibility of Procedure.

From the outset, the committee has proceeded on the theory that so delicate a mechanism as the modern stock exchange cannot be regulated efficiently under a rigid statutory program. Unless considerable latitude is allowed for the exercise of administrative discretion, it is impossible to avoid, on the one hand, unworkable 'strait-jacket' regulation and, on the other, loopholes which may be penetrated by slight variations in the method of doing business. Accordingly it is essential to entrust the administration of the act to an agency vested with power to eliminate undue hardship and to prevent and punish evasion. Of course, well defined limits must be indicated within which the authority of such administrative authority may be exercised.

The committee considers that the act would be administered effectively by a Commission of five, to be appointed by the President with the advice and consent of the Senate, specifically for that purpose.

In addition to the discretionary and elastic powers conferred on the administrative authority, effective regulation must include several clear statutory provisions reinforced by penal and civil sanctions, aimed at those manipulative and deceptive practices which have been demonstrated to fulfill no useful function. These sanctions are found in sections 9, 10 and 16. Moreover, the power to withdraw Federal registration is not a sufficient guarantee that the rules and regulations of the administrative authority, as well as the statutory provisions, will be observed; and accordingly the bill provides criminal penalties for violation of such rules and regulations. It is to be noted, however, that such penalties are limited to fines as distinguished from the penalties of imprisonment which may be inflicted for violation of the statutory provisions of the bill."

Office - Supreme Court
FILED
AUG 7 1954
HAROLD B. WILLEY,

No. 178

IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

CHARLES S. ROBERTS, upon his own behalf and on behalf of all other stockholders of OLD TOWN CORPORATION,
Petitioner,

v.

JOSEPH S. EATON, et al.,
Respondents,

and

OLD TOWN CORPORATION, et al.,
Defendants.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF FOR RESPONDENTS IN OPPOSITION

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August 6, 1954

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR RESPONDENTS IN OPPOSITION

The Court of Appeals for the Second Circuit unanimously affirmed a District Court judgment for respondents in an action brought under Section 16(b) of the Securities Exchange Act of 1934, 48 Stat. 896 (1934), 15 U. S. C. § 78p(b) (1952). That section is designed to discourage the use of inside information by directors, officers and principal stockholders to make profits for themselves through a short-term (less than six months) "purchase" and "sale" of stock in their corporation. The section forces

the insiders to pay over to their corporation the profit realized on any such transaction.

Section 16(b) became effective on October 1, 1934. Nearly all the actions under this section have been brought in the Second Circuit and our research discloses that all except two of the decisions by Courts of Appeal under the section have been by the Court of Appeals for the Second Circuit. No decision under Section 16(b) has ever been brought up by this Court for review, although many petitions have been presented. The instant petition certainly affords no suitable occasion for this Court to examine the statute for the first time.

The sole question here presented is whether a statutory reclassification of all the stock of Old Town Corporation constituted a "purchase" of the reclassified stock within the meaning of that word as used in Section 16(b). The decision of the Court of Appeals turned largely on the specific facts of this particular reclassification and on the conceded long-term holdings of respondents prior thereto. Given the set of facts as to the Old Town reclassification, the idea that any "purchase" was involved is farfetched in the extreme.

The reclassification at bar was in strict conformity with the Stock Corporation Law of New York. There was no short-term aspect to the interest of respondents in the corporation. Respondent Joseph S. Eaton had founded the business in 1917 and he and his family (the other principal respondents) had held their interest for many years. At the time of the reclassification, respondents owned about 45% of the outstanding stock. New York law required a 66⅔% vote of stockholders to authorize reclassification. There was a 78% vote of stockholders in favor of this reclassification.

The Court of Appeals found that there was "frank disclosure" to all stockholders (78), that there was "like treatment of all stockholders" (82), that the proportional

interest of respondents in the corporation was "unchanged" by the reclassification (83), and that there was no "individual option" to the respondents in the reclassification (80). The Court of Appeals referred to the full and complete reports made by respondents and by Old Town to the Securities and Exchange Commission (generally referred to herein as the "Commission") and to the fact that this "brought forth no adverse response from the Commission" (81); the Court did not accept this, however, as "conclusive of the issues" (81).

(The complete record on which this case was decided below has not been printed. For simplicity, we will follow the designation of page references adopted by petitioner. Page references preceded by "P.App." are in the printed, yellow cover, Appendix of Plaintiff-Appellant in the Court of Appeals. Page references preceded by "D.App." are in the printed, gray cover, Appendix of Defendants-Appellees in the Court of Appeals. Page references which are not preceded by any designation are in the printed proceedings in the Court of Appeals which are inserted in the printed Appendix of Defendants-Appellees in the Court of Appeals, beginning with page 77. Page references preceded by "Rec." are in the original unprinted record on file in this Court.)

After a careful study of the facts, the Court of Appeals found that in the particular type of reclassification here involved "the insider has no more knowledge than the rest of the world, and is not benefiting by the fruits of inside speculation" (83). The Court of Appeals then made the following significant finding on the facts of this case (83):

> "The reclassification at bar could not possibly lend itself to the speculation encompassed by § 16(b)."

The inevitable conclusion of law then followed that the reclassification was not a "purchase" under Section 16(b).

In here asking for the writ, petitioner does not claim that any rule of general application was laid down below, or that the decision on these particular facts is of any general interest, or that there is any conflict between Circuits. The petition recites (p. 10) that the decision below "is in conflict with prior authority and probably in conflict with applicable decisions of this Court" but these claims cannot be seriously made. The "prior authority" consisted almost entirely of decisions by the same Second Circuit Court of Appeals, which were carefully reviewed by that Court. Petitioner himself retreats from this claim when he later more guardedly states that "the courts of the respective Circuits *may* find themselves in conflict" (petition, p. 9; italics ours). There is no possible conflict with decisions of this Court because the statute has never been considered here.

The petition really rests on only one claim, not in any respect sustained, that the Court of Appeals "decided an important question of federal law which has not been, but should be, settled by this court" (Rule 19).

The argument for petitioner is that the Court of Appeals *exempted* the transaction in suit from the operation of Section 16(b), that the power to grant exemptions was conferred by the statute solely on the Commission, that the Court below invaded the province of the Commission, and that this "exercise of quasi-legislative discretion" (petition, p. 9) raises a question for review by this Court.

The decision below will not support any such argument. The Court of Appeals, as its opinion made plain (77, 79, 83), dealt with the problem as one of statutory interpretation. No question of *exemption* was in any way involved. An exemption under Section 16(b) assumes that the statute is applicable to the transaction *by its terms* but that the transaction, using the language of the statute, is not "within the purpose" of the statute and should be exempted. Nothing of this sort happened below. The deci-

sion was that no "purchase" under Section 16(b) took place and that in consequence the section was *not applicable by its terms.* There was neither exemption nor "exercise of quasi-legislative discretion" (petition, p. 9). There was the exercise of a *judicial* function to determine whether a given statute was applicable to the facts or not. There was no slightest effort by the Court of Appeals to perform the exemptive functions of the Commission and for petitioner so to suggest is exaggeration to an absurd degree. It may be observed in passing that the Commission itself has found no interference with its functions, has not sought to be heard either in the Courts below or here and declined an invitation of petitioner to participate as *amicus curiae.*

Opinions Below.

The opinion of the District Court (P.App. 30-36) is reported at 119 F. Supp. 362. The unanimous opinion of the Court of Appeals (77-83) is reported at 212 F. 2d 82.

Jurisdiction.

The jurisdictional requisites are adequately set forth in the petition (p. 2).

Question Presented.

The "questions" as framed in the petition (p. 6), aside from their excessive length, are entirely argumentative and otherwise inappropriate. We submit that on the record only one question is presented:

> Did the statutory reclassification of all the outstanding stock of Old Town Corporation constitute a "purchase" of the reclassified stock under Section 16(b) of the Securities Exchange Act?

Statute Involved.

Where stock of an "issuer" is registered on a "national securities exchange", Section 16(a) of the Act requires a report each month to the Securities and Exchange Commission by directors, officers and beneficial owners of more than 10% of the issuer's stock of all transactions by them in such stock. The stock of Old Town was registered on the American Stock Exchange, a "national securities exchange", and the required reports were duly filed by respondents (D.App. 17a, 21a, 31a-32a, 57a).

Section 16(b) of the Act is as follows (italics ours):

> "(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any *purchase* and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and

purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

Statement.

Respondent Joseph S. Eaton started the Old Town enterprise in 1916 with $300 and the help of his wife, respondent Lillian K. Eaton. The business was, and is, the manufacture and sale of typewriter ribbons, carbon paper and similar products. (D.App. 16a, 23a).

Old Town Corporation was organized under New York law in 1917. Its original capitalization of $2,500 was divided into 25 shares of $100 par value each, all owned by Joseph and Lillian K. Eaton. (D.App. 16a, 23a)

After thirty years of hard work in developing Old Town, Joseph Eaton began to think of diversifying his investments and slackening his own business activity (D.App. 26a).

Joseph Eaton's wife and their two children in 1947 sold 140,900 shares of Old Town stock to the public through The First Boston Corporation and other investment bankers. (D.App. 17a, 25a-26a)

In April 1951, the common stock of Old Town was registered on the New York Curb Exchange (now called the American Stock Exchange). This gave a broader market for the stock, making somewhat easier the eventual sale of the rest of the Eaton holdings. The business had grown to such an extent that its annual sales were more than five million dollars. The size and growth of the business involved increasing responsibilities to such an extent that Joseph Eaton, having spent many years in sustained business activity, was led to consider more seriously a curtailment of his work. (D. App. 17a, 21a, 26a)

In 1952, there were negotiations looking to a sale of the remainder of the Old Town stock owned by the Eatons

(D.App. 26a). It is not the fact that any sale was "worked out" before the reclassification or that the sale was "dependent" on the reclassification, as the brief for petitioner incorrectly asserts (p. 12). As the Court of Appeals found, the respondents did believe that the "marketability" of the stock "would be improved by reclassification" (78). This improvement would take place, of course, in all the outstanding stock.

At the end of 1952, a reclassification of Old Town stock was proposed (D.App. 26a). The statutory provisions governing the reclassification of stock of a New York corporation are contained in Sections 35, 37 and 38 of the Stock Corporation Law.

At meetings held in November and December, 1952, the directors of Old Town recommended for adoption by the stockholders the reclassification of its then outstanding 320,402 shares of common stock of $5 par value into

> 320,402 shares of common stock of $1 par value,

and

> 320,402 shares of 40¢ cumulative preferred stock of $7 par value. (D.App. 26a, 27a; P. App. 25-28).

The directors caused to be sent to each stockholder on December 8, 1952 a notice of special meeting together with a proxy statement setting forth in great detail the information concerning the proposed reclassification and concerning the negotiations for sale by the Eatons of their stock (D.App. 27a, 36a-54a). We need not debate the suggestion in the brief for petitioner (pp. 12, 13) that there was a failure to disclose information which petitioner deems material. The Court of Appeals specifically found that the facts as to the reclassification and as to the sale negotiations were "fully disclosed" (82).

The special meeting of stockholders was held on December 30, 1952 and at that meeting the reclassification was authorized by a vote of much more than two-thirds of the

outstanding stock. In fact, 78% of the ou
were voted in favor of the reclassificati
held by 675 stockholders. Only 0.85% of utstanding shares
shares (held by 23 stockholders) were vote ion. These were
tioner himself voted in favor of the recl f the outstanding
Certificate of Amendment was filed with ted against. *Peti-*
State of New York on January 12, 1953. *lassification.* The
and the proceedings in connection there the Secretary of
in accordance with New York law; upon This certificate,
ficate, the outstanding stock of Old Town with, were taken
by operation of law. (D.App. 27a; Rec. n filing the certi-

The ruling of the Treasury Departmen n was reclassified
tioner inaccurately refers (brief, p. 12) c. 37)
proposed recapitalization of the corpor nt, to which peti-
stitute a reorganization within the mea), was that "the
112(g)(1)(E) of the Internal Revenue C ration will con-
The word "exchange" was used elsewhere aning of Section
Department letter but only in the tax Code" (Rec. 39).
112(b) of the Internal Revenue Code, e in the Treasury
Treasury Department ruled that no gain sense of Section
holders of Old Town would result from th under which the
(Rec. 39). There was no "exchange" ph or loss to stock-
choice in any stockholder once the rec he reclassification
effective. hysically nor any
classification was

The President of Old Town sent a
stockholders on January 16, 1953, telling t letter to all its
classification was effective, that no exchan them that the re-
ficates was necessary, that the outstan ge of stock certi-
thereafter represented common stock o ding certificates
and that certificates for their preferred sto f $1 par value,
(D.App. 28a, 55a-56a) ock were enclosed.

The statement for petitioner sets fort
classification "new securities" were acqui h that in the re-
ents "in exchange for their old securitie ired by respond-
"new securities" were "substantially diff s" and that the
ferent" (brief, p.

13). This is not an accurate statement either of the legal or of the financial effects.

The reclassification in the case at bar substituted one share of $7 par value preferred stock and one share of $1 par value common stock for each share of $5 par value common stock outstanding. The capitalization of the preferred stock was made up of a reduction in the par value of the common from $5 to $1 together with a transfer from surplus (D.App. 41a, 42a). *The total capital and surplus remained exactly the same and the proportionate interest of each stockholder remained exactly the same.* True, the interest of each stockholder was differently represented after the reclassification because each then had both a preferred and a common stock; the *aggregate* interest of each stockholder, however, remained exactly the same. If the preferred stock had certain preferences, this in no way affected the stockholder because he received preferred stock in the reclassification; what he "lost" as a common stockholder, he "gained" as a preferred stockholder and vice versa. There was merely the division of an existing interest; no stockholder acquired any additional interest. This is mathematically certain.

The Courts below understood the facts correctly. The District Court found (P.App. 35):

> "The corporate shareholders acquired no additional interest in the corporation as a result of the reclassification. It was merely a division of their existing interest. Each stockholder retained what he had held all the while, in the same proportion, but in a somewhat different form."

The Court of Appeals found (83):

> ". . . after the change in the stock the Eatons continued interested in the same company, with their interests remaining proportionally unchanged . . ."

Under date of February 2, 1953, the principal respondents entered into contracts to sell all their Old Town com-

mon stock to James H. McGraw, Jr., members of his family and family trusts, and to sell all their Old Town preferred stock to two life insurance companies and one investment company. McGraw had been for more than fifteen years the head of McGraw-Hill Publishing Company, well-known publishers in New York of business and financial magazines and books. Such sales were consummated on February 10, 1953. (D.App. 22a, 28a-29a)

In connection with the sale to McGraw and in furtherance of Joseph Eaton's plan to retire from the active direction of the business, new executives were brought into Old Town and new directors were elected. *Petitioner* was elected executive vice president on February 10, 1953. At the annual meeting of stockholders on April 14, 1953 petitioner was elected a director and on the same date, at a meeting of directors, was elected president.

The board of directors of Old Town unanimously removed petitioner as president on May 25, 1953 for cause. (D.App. 30-31a)

Following his removal as president of Old Town, petitioner apparently determined to bring a series of "spite suits." He first commenced an action in the New York State Court against Old Town and McGraw. Then he made demand that Old Town bring suit against respondents under Section 16(b). At the time petitioner made his demand to institute suit, none of the respondents had any control of the board of directors of Old Town. On the contrary, ten of the thirteen directors were, and still are, completely independent of respondents; they are business men, bankers, a newspaper publisher, etc.—all of sufficient experience to judge properly of the interests of Old Town. (D.App. 34a, 23-24a)

The directors retained independent counsel to advise them concerning the Section 16(b) demand of petitioner. Counsel engaged were Messrs. Burns, Currie, Rich & Rice of 40 Wall Street (D.App. 34a, 35a). There was good rea-

son for the directors to select this part cular firm; Judge
Burns had formerly been General Couns l of the Securities
and Exchange Commission and his pa rtner, Mr. Currie,
had also been employed by the Commis ion as counsel.

The written opinion of Messrs. Bu ns, Currie, Rich &
Rice was given to the board on Augu st 13, 1953. This
opinion was that the reclassification coul l not be considered
a "purchase" under Section 16(b) and that since the pro-
spective defendants had owned their sto ck for many years,
there was no "purchase and sale" with in a period of less
than six months. The opinion recomm ended that the de-
mand of petitioner to institute suit be r efused by the cor-
poration. (D.App. 67-71a)

The directors followed the recomme ndation of counsel
and refused to bring the suit. None f the respondents
participated in this decision.

Thereupon petitioner commenced t his action.

Difference in Emphasis Between the Court of Appeals and the District Court.

As not infrequently occurs, the Cou rt of Appeals and
the District Court reached the same re ult but not on pre-
cisely the same reasoning. From this circumstance, peti-
tioner has the temerity to assert that the "Court of Ap-
peals rejected the respondents' content on and the District
Court's holding" (petition, p. 5). Ef ewhere, petitioner
by an *ipse dixit* declares that the tran saction in suit was
a Section 16(b) "purchase" (brief, p. 14) and then
blandly states that "the Court rej cted the contrary
holding of the District Judge" (bri f, p. 14). These
statements would almost suggest that t e Court of Appeals
had reversed the judgment for respon ents.

There was a difference in reasoni g between the Dis-
trict Court and the Court of Appeal but that this dif-
ference was slight and without signifi ance can be easily
seen from reading the opinions.

The District Judge emphasized that, like a stock dividend which had been earlier said by the Court of Appeals for the Second Circuit not to be a Section 16(b) "purchase" (*Shaw* v. *Dreyfus*, 172 F. 2d 140, cert. den. 337 U. S. 907), the reclassification at bar did not change the proportionate interest of any stockholder. The reclassification, said the District Judge, was, from the standpoint of all the stockholders, "merely a division of their existing interest" (P.App. 35); the reclassified stock "represented only what they had held prior to reclassification" (P.App. 36).

This reasoning was by no means "rejected" by the Court of Appeals, as the petitioner claims (petition, p. 5; brief, p. 14). Indeed, the Court of Appeals found "further reassurance" (83) in that reasoning but merely said that "we do not think it is *alone* enough" (83; italics ours). The Court of Appeals relied also on a number of other factors such as the equal treatment of all stockholders, the lack of individual options to the respondents, the absence of any independent value in a preexisting market for the reclassified stock, etc. (81-83). The Court of Appeals concluded that it might be "quite possible that no one of the factors . . . standing alone" would determine the question whether there had been a "purchase" under Section 16(b) but that "in cumulative effect" these factors clearly showed there was no such purchase and that "the decision below was correct" (83).

There were thus no significant differences between the District Court and the Court of Appeals.

Prior Consideration by This Court of the Case at Bar.

This Court has very recently denied a petition for a writ of certiorari to the Second Circuit Court of Appeals in a Section 16(b) case. In that petition, the opinion in the case at bar was printed in full as an appendix; claim

was made that a conflict existed between the decision there sought to be reviewed and the decision in the case at bar; and the case at bar was discussed at some length in the petition and in the briefs.

Mission Corporation v. *Blau*, 212 F. 2d 77 (2d Cir. 1954), cert. den. 347 U. S. 1016 (June 7, 1954).

POINT I.

The alleged "reasons for granting the writ" do not exist; the decision below did not usurp any "discretionary power" of the Securities and Exchange Commission.

The petition contains a statement of alleged "reasons for granting the writ" (pp. 6-10) and these are elaborated in a brief (pp. 14-22). We do not find any of the "reasons" very clear but as best we understand them they come down to the following:

(a) the decision below was not *judicial* action but was "an exercise of the Commission's power to exempt" (brief, p. 18, also pp. 17-20; petition, pp. 7-10); and

(b) the decision below limited recovery under Section 16(b) to those cases where there are "profits" which "can be demonstrably traced to the use of inside information" (petition, p. 7; brief, pp. 20-22).

Neither of these "reasons" has any validity because neither is an accurate statement of the decision below.

(a)

If the Courts below had found that there was in fact a "purchase" by respondents but had nevertheless granted an *exemption* from Section 16(b), such action would clearly have been improper. The power of exemption is conferred solely on the Commission. In this connection, we accept fully the principle of the *Scaife,* the *Addison* and the other cases cited by petitioner (brief, pp. 17, 18); this well-established principle is simply that the courts will not exercise discretionary powers committed by Congress to an administrative agency.

But no such thing happened here. Whether the transaction in suit was or was not a "purchase" within the meaning of that word as used in Section 16(b) presented the usual judicial problem of statutory interpretation.

There was never any occasion to consider the possibility of an "exemption" and no such point was ever argued or even mentioned. True, in reaching an interpretation of the word "purchase" as used in the statute, the Courts below did look to the *purpose* of the legislation. It is startling, however, that petitioner should describe this as the exercise of a "legislative and not a judicial power" (brief, 17). Petitioner's description is most grievously in error. To determine legislative purpose as an essential part of statutory interpretation is not the exercise of legislative power. One of the members of this Court spoke a few years ago about the proper judicial attitude toward the interpretation of statutes:

> "The generating consideration is that legislation is more than composition. It is an active instrument of government which, *for purposes of interpretation,* means that laws have ends to be achieved."
>
> Frankfurter, *Some Reflections on the Reading of Statutes,* 47 Col. L. Rev. 527, 538 (1947; italics ours).

Evidently the Securities and Exchange Commission did not feel that the judgment for respondents represented any "exemption" from the statute or any invasion of the Commission's prerogatives. Before the decision in the District Court, petitioner invited the Commission to participate as *amicus curiae* in the Court of Appeals but the Commission declined (D.App. 76a). A recent law review note has suggested that the Commission would approve the result reached by the Courts below in the case at bar (NOTE, 67 Harv. L. Rev. 1237, 1246; May 1954).

The only argument really open to petitioner in this Court is simply that the decision below was wrong. Petitioner realizes, however, that this argument will not support an application for a writ of certiorari. Petitioner is adroit, therefore, to present the matter *as if* the Courts below had granted an exemption from the Act and *as if* they had exercised a legislative function. This technique appears at its clearest in the following statement from petitioner's brief (p. 18; italics ours):

> "Under this principle it was improper in the case at bar for the Court *to exercise the Commission's power to exempt* the transaction in suit as not comprehended within the purpose of Section 16(b). The fact that this was done *through judicial interpretation* of 'purchase' for purposes of Section 16(b) does not change the substance of what has actually occurred."

All this amounts to is a claim that the decision below was wrong. The only basis for the claim is petitioner's argument that there was in fact a "purchase" under Section 16(b). There is nothing in any such claim or argument to justify granting the writ.

(b)

Petitioner describes the decision of the Court of Appeals as follows (petition, p. 7):

> "The Court below proceeded as if the intent and effect of the legislation are to provide only for the recapture of those profits that can be demonstrably traced to the use of inside information. . . ."

This is by no means correct. The Court of Appeals flatly declared that the "statutory mandate" was "to curb insider short-swing speculation" (80). The Court of Appeals did not limit "the statutory mandate", as petitioner argues, to those cases where profits were "demonstrably traced to the use of inside information" (petition, p. 7). In fact, the same Court in an earlier case had expressly rejected any such limitation, declaring, through the same Circuit Judge who wrote the opinion in the case at bar, as follows:

> "A subjective standard of proof, requiring a showing of an actual unfair use of inside information, would render senseless the provisions of the legislation limiting the liability period to six months, making an intention to profit during that period immaterial, and exempting transactions wherein there is a bona fide acquisition of stock in connection with a previously contracted debt."
>
> *Smolowe* v. *Delendo Corporation*, 136 F. 2d 231, 236 (2d Cir.; CLARK, *C. J.*) cert. den. 320 U. S. 751 (1943).

What the Court found was that the transaction at bar "is not *susceptible* to abuses within the ambit of § 16(b)" (82; italics ours). Petitioner attempts to weaken the force of this finding by asserting that the Court recognized its action to be taken in "a field in which it is inadequately informed" (petition, p. 9; brief, p. 19). There is nothing whatever in the Court's opinion to justify any such assertion or to indicate that any additional information, either in the "field" or in respect of the transaction at bar, was necessary or desirable.

POINT II.

The decision below was correct.

After "frank disclosure" (78), the holders of 78% of the stock of Old Town Corporation voted for the statutory reclassification (D.App. 27a).

Before reclassification, there were outstanding 320,402 shares of common stock of $5 par value, or a total capital of $1,602,010 applicable to stock. There was $232,814 of capital surplus and $1,867,534.08 of earned surplus, or a total capital and surplus of $3,702,358.08 (D.App. 41a-42a).

After reclassification, there were outstanding 320,402 shares of common stock of $1 par value, with a capital of $320,402 applicable thereto, and 320,402 shares of preferred stock of $7 par value, with a capital of $2,242,814 applicable thereto. There was a total capital of $2,563,216 applicable to stock, or $961,206 more than before reclassication. This additional capital of $961,206 represented $232,814 transferred from capital surplus and $728,392 transferred from earned surplus. The *total* of capital and surplus remained at $3,702,358.08, exactly the same as before reclassification (D.App. 41a-42a).

Each share of common stock of $5 par value was reclassified into one share of common stock of $1 par value and one share of preferred stock of $7 par value. No share certificates were exchanged. The common stock certificates continued to represent common stock. Preferred stock certificates were delivered to all stockholders, without any action whatever by the stockholders themselves (D.App. 28a, 55a-56a).

No additional interest in Old Town was acquired by respondents or by any other stockholders. The situation amounted to no more than a simultaneous reduction in par value of the common stock and declaration of a dividend in preferred stock out of the surplus created by this

reduction and out of the surplus already existing. This Court has expressly recognized that a dividend in preferred stock on common stock (where, as in the case at bar, there was previously no preferred stock outstanding) makes no change in the interest of the stockholders in their corporation.

> "While the petitioner in No. 66 received a dividend in preferred stock, the distribution brought about no change whatever in his interest in the corporation. Both before and after the event he owned exactly the same interest in the net value of the corporation as before."
>
> *Strassburger* v. *Commissioner of Internal Revenue,* 318 U. S. 604, 607 (1943).

The Court of Appeals for the Second Circuit in an earlier case has stated that receipt of a stock dividend is not a "purchase" under Section 16(b).

> *Shaw v. Dreyfus,* 172 F. 2d 140, cert. den. 337 U. S. 907 (1949).

The reclassification at bar, after the necessary vote and filing of a certificate of amendment, became effective *as a matter of law.* There was *no choice* given to the stockholders whether their stock should be reclassified or not. All the stock was reclassified by operation of law. This is a significant distinction from an earlier case in the Second Circuit where the voluntary conversion of a preferred stock into common stock at the choice of individual insiders was held to be a Section 16(b) "purchase".

> *Park & Tilford, Inc.* v. *Schulte,* 160 F. 2d 984, cert. den. 332 U. S. 761 (1947).

There was no purchase price paid in the case at bar. Petitioner suggests that "new securities" were acquired by the stockholders "in exchange for their old securities"

(brief, p. 13). This is not true. No consideration was paid and nothing given up by the stockholders; there was not any "exchange". The interest of each stockholder in Old Town Corporation remained precisely the same.

In the reclassification at bar, *all stockholders were treated exactly alike.* Respondents obtained nothing in the reclassification not obtained by everybody else, including petitioner himself (D.App. 34a). Petitioner suggests (brief, pp. 20, 21), as an example of possible abuse, that an insider, knowing of adverse developments, might wish to sell out and, to improve the marketability of his stock, might promote such a reclassification as that at bar. But does this mean anything as far as Section 16(b) is concerned? Clearly not, for any improvement in marketability would take place equally as to all the other stock. Moreover, an improvement in marketability is by no means the same thing as a "purchase".

In view of the significant and controlling factors here present, the District Court was right in its conclusion (P.App. 35):

> "To say that any Old Town shareholder 'purchased' his stock upon the reclassification is to twist the word 'purchase' beyond all semblance of recognized meaning."

The Court of Appeals, although proceeding "on somewhat different grounds" (79) than did the District Court, was equally right in its conclusion (83):

> "The reclassification at bar could not possibly lend itself to the speculation encompassed by § 16(b). This being so, it was not a 'purchase' and the decision below was correct."

POINT III.

There are in the case at bar no "special and important reasons" as required by Rule 19 for granting a writ of certiorari; the petition should be denied.

Respectfully submitted,

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August 6, 1954.

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No. 178

IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

CHARLES S. ROBERTS, upon his own behalf and on behalf of all other stockholders of OLD TOWN CORPORATION,

Petitioner,

v.

JOSEPH S. EATON, et al.,

Respondents,

AND

OLD TOWN CORPORATION, et al.,

Defendants.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF OF PETITIONER

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August 12, 1954

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REPLY BRIEF OF PETITIONER

This reply brief deals only with the respondents' argument regarding Question No. 1 presented in our petition (p. 6), discussed in Points I and II of the brief attached thereto (pp. 14-20).

The respondents agree that under Section 16(b) "The power of exemption is conferred solely on the Commission" and may not be exercised by the courts (Respondents' Brief, p. 15). Their only contention is that "no such thing happened here" (*ibid.*) and therefore our first question is not presented.

But the only ground for a grant of exemption by the Commission is that the exempted transaction is "not comprehended within the purpose" of Section 16(b) (viz., to prevent

unfair use of information by insiders); and it was on precisely that ground, and that ground alone, that the Court below held that there was no "purchase" in this case within the meaning of the section.

The respondents' reliance is therefore upon the circumstance that the Court did not *say* that it was granting an "exemption" upon the statutory ground, but declared instead that it was "immunizing" the transaction upon that ground. This is an argument of semantics, not of substance.

Whether the action of the Court below be called "exemption" or "immunization" does not touch the substance. The nature of the action, the ground therefor, and the result, are identical under either characterization.

Accordingly, the error and ill consequences set out in our petition and brief are indeed presented for consideration. These the respondents' brief does not touch.

The writ prayed for should be granted.

Respectfully submitted,

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Petitioner.

August 12, 1954.